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In the Supreme Court of the United States

OCTOBER TERM, 1965.

No. 742.

CITY OF CLEVELAND, OHIO,

Petitioner,

v.

PUBLIC UTILITIES COMMISSION OF OHIO,

and

CLEVELAND ELECTRIC ILLUMINATING COMPANY,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF OHIO.

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November 15, 1965.

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CITY OF CLEVELAND, OHIO,

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PUBLIC UTILITIES COMMISSION OF OHIO,

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CLEVELAND ELECTRIC ILLUMINATING COMPANY,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF OHIO.

The petitioner prays that this Court issue a writ of certiorari to review the judgment of the Supreme Court of the State of Ohio entered on the seventh day of July, 1965, in the case of City of Cleveland, Ohio, Appellant, vs. Public Utilities Commission of Ohio, Appellee, Cleveland Electric Illuminating Co., Intervening Appellee, on appeal from the Public Utilities Commission of Ohio.

OPINIONS BELOW.

The Public Utilities Commission of Ohio in its *"Findings and Order"* of January 8, 1963, in Case No. 30,109 granted in full the amended application of the Cleveland Electric Illuminating Company for an increase in its steam rates. The Commission's *Findings and Order* of January 8, 1963, is attached hereto as Appendix A. The Commission's opinion was reported at 47 PUR 3d 44 (1963).

The opinion of the Supreme Court of the State of Ohio affirming the decision of the Public Utilities Commission (hereinafter referred to as the "Commission") is attached hereto as Appendix B. The Court's opinion was reported at 3 Ohio State 2d 82 (1965).

JURISDICTION.

Petitioner seeks a review by this Court of the Opinion of the Supreme Court of Ohio of July 7, 1965, which has an entry date of July 7, 1965. The Opinion has been appended hereto as Appendix B. The City of Cleveland's request for a rehearing was denied by the Supreme Court of Ohio on August 19, 1965.

The jurisdiction of this Court is invoked under 28 U. S. C. Sec. 1257 (3), since the petitioner and those whom it represents were deprived by the Public Utilities Commission of Ohio and the Supreme Court of Ohio of their property without due process of law in violation of the Fourteenth Amendment to the Constitution of the United States.

QUESTIONS PRESENTED.

The fundamental questions of extreme national importance raised by this petition for a writ of certiorari are:

1. Are ratepayers of privately owned utilities protected by the Fourteenth Amendment to the Federal Constitution against the confiscation of their property through excessive rates set by state regulatory bodies?

2. May the Public Utilities Commission of Ohio deprive the petitioner and the other ratepayers of due process of law, in violation of the Fourteenth Amendment to the Federal Constitution, by granting

to the Company the unregulated power to adjust its rates according to a modified version of a coal escalation formula which had not worked except defectively in forty years?

3. May the Public Utilities Commission of Ohio deprive the petitioner and the other ratepayers of due process of law, in violation of the Fourteenth Amendment to the Federal Constitution, by ordering a retroactive rate increase to be applied in an arbitrary and discriminatory manner.

CONSTITUTIONAL PROVISIONS INVOLVED.

No statutes are involved in this case. The only constitutional provision involved is Section 1 of the Fourteenth Amendment to the Federal Constitution which is as follows:

> "All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

STATEMENT OF THE CASE.

The Cleveland Electric Illuminating Company (hereinafter referred to as the Company) has a monopoly on the sale of steam heating service in downtown Cleveland. The operation involved is essentially a rather simple one. The Company burns coal in order to convert water into steam. The steam is then channeled through a series of pipes to

the Company's customers. The bulk of the property involved in this case consists of two steam generating plants and many sizes and kinds of underground conduit.

The Commission Has Confiscated the Ratepayer's Property.

Decades ago in less prosperous times the privately owned utilities came before this Court and asked for protection against rates set through state action which were too low. The utilities said that they were entitled to the protection of the Fourteenth Amendment to our Federal Constitution (hereinafter called the "Fourteenth Amendment") against rates which resulted in the confiscation of their property. This Court determined that they were entitled to that protection.

Petitioner appears now before this Court asking for protection against rates set by our Commission which are so excessive that they confiscate the ratepayer's property. *The Supreme Court of the United States has never spoken on this point.* The importance of this point on a nationwide basis is staggering even in this era of astronomical sums.

Ohio utility companies and counsel for the Commission now shamelessly advance the one-sided proposition that the utilities are entitled to the protection of the Fourteenth Amendment against unreasonably low rates but that the ratepayer is not entitled to protection against excessively high rates. The Supreme Court of Ohio has been deaf to our plea for protection against excessive rates and has therefore, by its silence in this and other cases, given its tacit approval to the contentions of the utilities and the Commission that the ratepayer is not protected by the Fourteenth Amendment.

There is undoubtedly a zone of reasonableness which covers the difference between the point at which the confiscation of the utility's property through an inadequate return ends and the point where the confiscation of the ratepayer's property through the allowance of an excessive return begins. The rate of return evidence introduced by the City of Cleveland established the maximum return which the applicant can be reasonably allowed. Anything in excess of that return would clearly result in the confiscation of the property of the ratepayer.

Mr. James M. Honaker, a highly qualified rate of return expert from Frankfort, Kentucky (Tr. 2448-9), testified that the maximum allowable return is $525,000 per year (Tr. 2451). Such a return would consist of an 8% rate of return on composite capitalization and a 13% rate of return on the common equity portion thereof (Tr. 2451). Mr. Honaker testified that even that return might be excessive. He stated on pages 2451-2 of the record that

> "Anything beyond this is completely out of line with the generally accepted concept of fair return. In fact, these percents are entirely too high and at first blush shock the conscience, but my stated opinion is premised upon an extreme situation, i.e., earnings outside a broad and generous zone."

Cleveland introduced the only evidence in this case as to what would be a confiscatory rate. The Commission disregarded this evidence and on page 9 of its final order in this case determined that "* * * The dollar return to which applicant is entitled for purposes of this proceeding is $680,311.11 * * *."

The vehicle employed for justifying these enormous profits is Ohio's statutory reproduction cost new valuation formula (hereinafter referred to as "RCN"). RCN is the cost of exactly duplicating all of the Company's property

at current prices even though some of the property may predate the turn of the century. The formula is applied even if the property is useless from an economic point of view. Under RCN it is not uncommon for a rate base to be more than three times as large as that which would be obtainable under an original cost rate base such as the one employed by the Federal Power Commission and most of the states of the Union. Since RCN allows an almost limitless ballooning of the rate base it is possible for a low rate of return under RCN to produce enormous rates of return on a utility's capital and common equity investments. In this case a 3.53% rate of return under RCN produced a 10% return on the Company's capital investment and over 15% on its common equity.

The fact that the Commission allowed a very modest rate of return under RCN is no justification for the allowance of a return that is excessive by all practical standards of measurement. The Constitution of the United States is intended to preserve practical and substantial rights, not to maintain intricate theories. *Faitoute Iron & Steel Co. v. Asbury Park*, 316 U. S. 502, 514 (1942); *Davis v. Mills*, 194 U. S. 451, 457 (1904).

The impracticality of RCN is readily demonstrated by the valuations attributed to the Company's property. For instance, the Company arrived at an undepreciated valuation for its much smaller Canal Road Plant buildings of $3,578,107 compared to an undepreciated valuation of $3,071,732 for its larger buildings at East 20th Street (page 1 of Company Exhibit 9). Smaller boilers were given greater valuations than larger boilers (Tr. 977-8).

Mr. Honaker was the only witness to show the practices prevailing in the money markets for measuring a company's earnings requirements. It is only Mr. Honaker's

testimony and his exhibit that present the practical standards for measuring the constitutionality of the rates set by the Commission. This Court has long held that whether state law deprives a party of his rights secured by the Constitution depends upon the law's practical application and effect. *Near v. Minnesota,* 283 U. S. 697, 708 (1931); *Mountain Timber Co. v. Washington,* 243 U. S. 219, 237 (1917). The effect of state law must be judged in the light of its application to the affairs of men as they are ordinarily conducted. *North Laramie Land Co. v. Hoffman,* 268 U. S. 276, 283 (1925).

The Company's Coal Escalation Formula.

The Company has had an escalation clause for the cost of its coal since 1920 (Tr. 743). *This clause has not worked at any time during its forty years of existence* (Tr. 743-4). If the cost of coal went up one dollar over the last decade, the Company's charges to its customers would increase by one dollar and forty cents. If the cost of coal were to go down, then the Company's revenues would decrease at an even greater rate (Tr. 687-690).

The Company never caught this defect, nor did the Commission. The Commission does not check the operation of such a formula, the administration of which is left to the discretion of the Company. The Company admitted that its formula does result in frequent changes in rates (Tr. 700-1).

After these disclosures the Company modified its formula so as to bring its working in closer harmony with current fuel costs. This, however, does not change the fact that escalation as allowed by the Commission has been and will continue to be an unconstitutional delegation by the Commission to the Company of its regulatory powers

to set rates. Furthermore, the Company's escalation clause is rather ambiguous and is dependent upon interpretations and practices of the Company (T. 747-8).

There is no protection to the petitioner and the other ratepayers against future changes in the cost of fuel which would produce similar disparities. Some of these possibilities are shown on pages 694-9 of the record. Increased efficiency resulting from modern generating plants is ignored in the so-called "fuel clause." The escalation is not based upon the cost of coal per unit of energy, but upon the cost of coal per ton even if very little is used per kilowatt hour generated.

The Commission Has Acted Discriminatorily and Retroactively.

The Commission's decision was rendered on January 8, 1963. The new rates were applied by the Company on all its bills that were rendered after January 8, 1963. On a bill rendered on January 9, 1963, the ratepayer would pay at the higher rate for one month's consumption prior to the billing date. The consumption of such a customer would have occurred entirely during a period of time when the lower rates were in effect. Due to the fact that there is a lag of almost two weeks between the date a meter is read and the date the bill is rendered, the consumption period for a customer billed on January 9, 1963, would be from about November 28, 1962, through December 27, 1962. A customer billed on January 10, 1963, would have consumed steam service from November 29, 1962, through December 28, 1962, and so on. It can be seen then that for the first two weeks after January 8, 1963, the Company's customers were billed entirely at the higher rates, when in fact the consumption took place entirely during a period of time when the lower rates were in effect.

The most signal result of this procedure is that a consumer billed on January 8, 1963, would pay the lower rates for his consumption of steam service between November 27, 1962, and December 26, 1962, while a consumer billed on January 9, 1963, would pay the higher rates for his consumption of steam service over substantially the same period of time (from November 28, 1962 through December 27, 1962). This discrimination is in violation of the Fourteenth Amendment.

The only reason advanced by either the Company or the Commission for the retroactive and discriminatory manner in which these rates were put into effect is that it is a "mechanical procedure" which is easy to administer. In short, both the Company and the Commission rely on the proposition that the *end* justifies the *means*. The proper application of the rate increases could have been devised and utilized in a "mechanical procedure." No effort has been made by either the Commission or the Company to do this.

A utility is in the position of making a continuing offer to render a service which is accepted by its ratepayers on a day to day basis through the use of said service. To alter the charge after the service has been rendered is in effect to change the terms of the agreement.

The constitutional rights of the ratepayer to make contracts and to be free of discriminatory practices on the part of the state are far too weighty to be set aside for the mere convenience of the Company.

The Federal Questions Were Timely Raised.

All of the matters complained of in this petition for writ of certiorari arose as a result of the Commission's *Findings and Order* of January 8, 1963. All of these matters were raised as error in our application to the Commis-

sion for a rehearing and in our Notice of Appeal of April 30, 1963, to the Supreme Court of Ohio. All of these matters were discussed in our initial and reply briefs before the Supreme Court of Ohio, and were the subject for an "Application for Rehearing by the City of Cleveland" to the Supreme Court of Ohio.

Petitioner's Position.

The City of Cleveland prosecutes this case both as a ratepayer and as a representative of the ratepayers served by the Company.

REASONS FOR GRANTING THE WRIT.

I.

The Right of the Ratepayer to the Protection of the Fourteenth Amendment Against Confiscatory Rates Set by State Regulatory Bodies Is a Matter of Extreme General Importance Which Has Never Been Decided by This Court.

This case raises the question about whether the Ohio ratepayer can raise the shield of the Fourteenth Amendment to the Federal Constitution against the confiscation of his property through excessive rates set by the Public Utilities Commission of Ohio for services rendered by privately owned utilities. The Supreme Court of the United States has upon many occasions granted the protection of the Fourteenth Amendment to privately owned utilities against the confiscation of their property through insufficient rates set by state regulatory bodies, *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia*, 262 U. S. 679, 683 (1923). This Court, however, has never decided whether the ratepayer

is entitled to the same protection against the confiscation of his property through excessive rates.

The Public Utilities Commission of Ohio (hereinafter referred to as the "Commission") and the Supreme Court of Ohio have consistently refused to give the equal protection of the law to the ratepayer. Counsel for the Commission on page 5 of their brief before the Supreme Court of Ohio stated:

> "* * * The constitutional protection to which a utility is entitled because of the burden of regulation cannot be extended to that utility's ratepayers, who are *not* so regulated."

This appears to reflect the thinking of the Commission itself. Counsel for the Commission also showed on page 5 of their brief that the Supreme Court of Ohio has refused in the case of *City of Dayton v. Public Utilities Commission of Ohio*, 174 Ohio State Reports 160 (1962), to consider the right of the ratepayer to claim the protection of the Fourteenth Amendment against the confiscation of his property through excessive rates set by the Commission.

The question raised by this appeal is of enormous general importance. Each year ratepayers in Ohio pay many hundreds of millions of dollars to privately owned electric, gas, telephone, water, and steam utilities in accordance with rates set by the Commission. The national total is over 20 billion dollars per year. The services provided by these utilities are necessities of life. Normally the ratepayer is unable to defend himself against the rates set by the Commission, since he must purchase these services and he lacks any real choice of competing or substitute services. Surely the property of the ratepayer can just as readily be confiscated through excessive rates as the

property of the utility can be confiscated through insufficient rates.

The utility patron is just as entitled to have his property protected from confiscation as is the utility operator. If he is not, then he does not receive the equal protection of the law guaranteed to him by the Fourteenth Amendment.

The primordial question in any case involving due process is "Has the action of the state, through any of its branches, legislative, judicial, or executive, been the cause of a deprivation of life, liberty or property?" Cleveland and other ratepayers are just as affected by the rates set by the Commission as the Company is, and we have an equal right to the protection of the Fourteenth Amendment. We should not be left at the mercy of the Commission which has shown no concern for our basic property rights.

Cleveland introduced the only evidence in this case about what return would confiscate the ratepayer's property. As previously stated, Mr. Honaker showed that the allowance by our Commission of any return in excess of $525,000 per year would confiscate our property. Mr. Honaker testified that a return of $525,000 per year would consist of an 8% rate of return on capitalization and a 13% rate of return on common equity (Tr. 2451). He stated on pages 2451-2 of the record that:

> "Anything beyond this is completely out of line with the generally accepted concept of fair return. In fact, these percents are entirely too high and at first blush shock the conscience, but my stated opinion is premised upon an extreme situation, i.e., earnings outside a broad and generous zone."

The Commission, on page 9 of its final order, allowed a return of $680,311.11 per year.

II.

The Allowance of an Excessive Return to a Privately Owned Utility Is the Equivalent of Granting It the Power to Levy Taxes.

Since time immemorial one of the principal sources of revenues to governments has been through state regulated monopolies. An interesting illustration of this is the "gabelle" or salt tax, which in large measure was responsible for the French Revolution. There is no virtual difference between being required by law to pay a tax or being required to pay the tax because it is a prerequisite to securing a necessity of life.

It seems that the tolerance of any monopoly, particularly over a necessity of life, is in effect a delegation of the power of taxation. In our country the delegation of the power of taxation by the legislature to some other body is unconstitutional. The only way that the granting of a monopoly by a municipality or a state to a privately owned corporation can be reconciled with the prohibition against the delegation of the power of taxation is when the resultant profits are not "profits" in the usual sense of the word but are nothing more than compensation for the continuing cost to the corporation of attracting and retaining the capital necessary for meeting its obligation to serve the public. Such a rationale is not available in this case, since the return set by the Commission grossly exceeds the Company's cost of attracting and retaining the capital necessary for its continued operation.

Monopolies are basically inconsistent with our way of life. The privately owned utilities have a power which, if they were not regulated, would be destructive of our fundamental rights. Monopolies have the power to take private property and to deny its owners the "pursuit of

happiness." Monopolies can only be tolerated when they are subject to strict regulation. The excessive return allowed in this case is intolerable.

III.

The Commission Has Unconstitutionally Delegated Its Powers to the Company.

This Court, in *Carter v. Carter Coal Co.*, 298 U. S. 238, 80 L. ed. 1160, held that Congress could not delegate to a majority of miners its authority to fix minimum wages for a district or group of districts. Mr. Justice Sutherland, who wrote the majority opinion, stated at page 311:

> "The power conferred upon the majority is, in effect, the power to regulate the affairs of an unwilling minority. This is legislative delegation in its most obnoxious form * * * and a statute which attempts to confer such power undertakes an intolerable and unconstitutional interference with personal liberty and private property. The delegation is so clearly arbitrary, and so clearly a denial of rights safeguarded by the due process clause of the Fifth Amendment, that it is unnecessary to do more than refer to decisions of this court which foreclose the question. *Schechter Corp. v. United States*, 295 U. S. at p. 537; *Eubank v. Richmond*, 226 U. S. 137, 143; *Seattle Trust Co. v. Roberge*, 278 U. S. 116, 121-122."

The Supreme Court of the United States in *Seattle Trust Co. v. Roberge*, 278 U. S. 116, determined that the State legislature of Washington could not require that an applicant for a building permit obtain the written consent of owners of two-thirds of the property within 400 feet of the proposed building. The Court held at page 122 that:

> "* * * The delegation of power so attempted is repugnant to the due process clause of the Four-

teenth Amendment. Eubank v. Richmond, 226 U. S. 137, 143. Browning v. Hooper, 269 U. S. 396."

In this case the Commission has given the Company the unrestrained power to adjust its rates in accordance with a coal escalation formula. The Company's power is unrestrained because the Commission has not once examined the operation of the coal escalation formula during the forty years prior to the commencement of the present case. Cleveland has shown that the coal escalation formula has not worked equitably at any time during its forty years of existence (Tr. 743-4). How else can this sad fact be explained except by the obvious conclusion that our Commission never checks into the working of such formulae?

Yet, the Commission still gives the Company the power to alter at will the charges that its ratepayers must pay in accordance with a modified version of the old coal escalation formula. The Commission through its approval of the coal escalation formula continues to delegate its regulatory authority to fix rates to the Company. How could any delegation of power be more irreconcilable than this with the due process clause of the Fourteenth Amendment to our Federal Constitution?

IV.

Contrary to the Decisions of This Court the Commission Has Arbitrarily Granted a Discriminatory Rate Increase Which Violates the Petitioner's Freedom of Contract.

This Court, in *Nebbia v. New York*, 291 U. S. 502 (1934), held that discriminatory prices established by governmental action were illegal. As we showed before, the Company did not apply the same rates to the same periods of consumption. Instead the Company, pursuant to

the Commission's orders, applied the increased rates to all its billings after January 8, 1963, regardless of the period of consumption involved. Thus the ratepayer's bill for services rendered before January 9, 1963, was dependent not upon the rate that was in effect at the time of his consumption but upon whether or not he happened to be billed after January 8, 1963. As we also showed in our statement of the case, the practice of basing rates upon the billing date rather than on the date the service was rendered resulted in different charges for the same service rendered over the same period of time. Such discrimination is clearly in violation of this Court's findings in *Nebbia v. New York*, 291 U. S. 502 (1934).

Furthermore, by this action the Commission has unreasonably interfered with the ratepayer's freedom of contract. Liberty of contract is an inherent and inalienable right, universally recognized to be within the protection of the Fourteenth Amendment to our Federal Constitution, *West Coast Hotel Co. v. Parrish*, 300 U. S. 379, 81 L. ed. 703, 108 A. L. R. 1330.

A utility is in the position of making a continuing offer to render a service which is accepted by its ratepayers through the use of said service. To alter the charge after the service has been rendered is in effect to change the terms of the agreement. The Commission's order that the Company's proposed "* * * tariff schedules may become effective on the first billing date subsequent to the filing of such tariff schedules" (page 9 of the Commission's Findings and Order of January 8, 1963) failed to recognize the fact that the first billings would largely be for services rendered prior to the permitted date of the rate increase. The result of this retroactive procedure was to allow the Company to alter the charges after the ratepayer had accepted the Company's offer to render service under the

prior rates, and had actually already received the service. The Commission's allowance of a retroactive rate increase is an arbitrary alteration of the agreement entered into between the Company and its customers. The ratepayer was thereby denied his freedom of contract in violation of the Fourteenth Amendment.

CONCLUSION.

WHEREFORE, the petitioner prays that a writ of certiorari directed to the Supreme Court of the State of Ohio may issue under the seal of this Honorable Court in this cause and that upon such review the judgment of the Supreme Court of Ohio entered on July 7, 1965, and the "Findings and Order" of the Commission of January 8, 1963, be vacated, reversed, and set aside and that this case be remanded to the Supreme Court of Ohio with instructions to proceed in accordance with the rulings of this Court.

Respectfully submitted,

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APPENDIX A.

FINDINGS AND ORDER OF THE PUBLIC UTILITIES COMMISSION OF OHIO.

The Commission coming now to consider the above entitled application, the amended application, and the testimony and exhibits adduced at the public hearings, and being otherwise fully advised in the premises hereby renders its findings and order in compliance with the applicable statutes.

HISTORY OF THE PROCEEDINGS:

On April 27, 1961, the Cleveland Electric Illuminating Company filed with this Commission an application, with certain attached exhibits, seeking authority to increase the rates which it charges for steam and hot water service in the city of Cleveland, Ohio, by amending its filed schedule P. U. C. O. No. 6.

April 27, 1961. Motion filed by applicant requesting approval of a form of legal notice to be published.

May 9, 1961. Entry issued approving form of legal notice.

September 11, 1961. Petition to Intervene filed by the city of Cleveland.

September 20, 1961. Entry issued granting the Petition to Intervene.

March 5, 1962. The Commission's staff report of investigation filed and served as required by law.

April 4, 1962. Objections to the staff report of investigation filed by the city of Cleveland.

April 4, 1962. Objections to the staff report of investigation filed by Cleveland Electric Illuminating Company.

May 12, 1962. Exhibits and written testimony of applicant's witnesses filed.

May 22, 1962. Public hearings were held in this matter in the offices of the Commission on May 22, 23, 24, 25; June 19, 20, 21, 22; August 15, 16, 21, 22, 23, 24, 28, 29, 30, 31; September 11, 13, 14; October 23 and 24.

October 6, 1962. Motion filed by city of Cleveland to extend the time to complete its case.

October 10, 1962. Brief in opposition to the above motion filed by applicant.

October 11, 1962. Entry issued denying the motion.

October 17, 1962. Written testimony of city of Cleveland witnesses filed.

November 19, 1962. Brief filed by the city of Cleveland.

November 26, 1962. Reply brief filed by applicant.

December 7, 1962. Motion to reopen filed by applicant.

December 7, 1962. Entry issued reopening case and setting hearing for December 14, 1962.

December 13, 1962. Motion filed by the city of Cleveland for reconsideration of the Commission's order reopening the proceedings and for a change of the December 14, 1962 hearing date.

December 13, 1962. Motion filed by the city of Cleveland requesting correction of typographical errors in its motion filed December 13, 1962.

December 13, 1962. Motion to reopen filed on December 7th withdrawn.

December 13, 1962. Amendment to application filed by applicant.

APPEARANCES:

Messrs. Lee C. Howley, Vice President and General Counsel and Harry G. Fitzgerald, Jr., Counsel, 55 Public

Square, Cleveland 13, Ohio, on behalf of the Cleveland Electric Illuminating Company.

Squire, Sanders & Dempsey by Messrs. John Lansdale and Alan P. Buchmann, Counsel, 1857 Union Commerce Building, Cleveland 14, Ohio, on behalf of Cleveland Electric Illuminating Company.

Mayor Ralph S. Locher, Mr. Bronis J. Klementowicz, Director of Law, and Messrs. William T. McKnight and James L. Harkins, Jr., Assistant Directors of Law, 204 City Hall, Cleveland 14, Ohio, on behalf of the city of Cleveland and the Cleveland Public Library.

Honorable Mark McElroy, Attorney General, State of Ohio, by Messrs. Andrew R. Sarisky and Herbert T. Maher, Assistant Attorneys General, on behalf of the Public Utilities Commission of Ohio.

COMMISSION DISCUSSION:

AMENDMENT TO APPLICATION.

On December 13, 1962, the applicant filed with the Commission an amendment to its application. The amendment conforms the application to the terms of an agreement which was entered into between applicant and all of its steam customers except the city of Cleveland and the Cleveland Public Library.

The amendment withdraws a tax adjustment clause, earlier proposed, amends an earlier proposed fuel adjustment clause and requests approval of the following rates,

(a) Meter Rates

For the first 250,000 pounds per month per 1,000 pounds $1.575

For the next 250,000 pounds per month per 1,000 pounds $1.555

For the next 500,000 pounds per month per 1,000 pounds $1.535

For the next 2,000,000 pounds per month per 1,000 pounds $1.515

For all excess over 3,000,000 pounds per month per 1,000 pounds $1.50

(b) Flat Rate

"$1.155 per square foot of direct air radiating surface per heating season."

RATE BASE.

(a) Valuation.

The company and the Commission's engineering staff presented estimates of a statutory rate base as of June 30, 1960, the date certain, to be used for testing rates in this proceeding. The estimates are summarized as follows:

	Company	*Staff*
Reproduction Cost New	$26,671,115	$26,680,511
Less Depreciation		
(29.82%)	7,953,145	
(29.1%)		7,878,201
Reproduction Cost New Less Depreciation	$18,717,970	$18,802,310
Land and Land Rights	432,873	357,454
Work in Progress	4,566	4,566
Working Capital	697,000	37,111
Rate Base	$19,852,409	$19,201,441

The reproduction cost new valuation proposed by the company was arrived at by tabulating the historical cost for each class of property, taken from the records of the company, and applying to these costs trend factors or indices which were derived for the most part from the company's records of the year-by-year cost of the various types of property.

The Commission's engineers, being familiar with the company's cost-keeping methods and believing them to be reliable, accepted the tabulations of historical cost. After carefully considering the trend factors used by the company and checking them against other published trends, the Commission's engineers found them to be essentially similar to, if somewhat more conservative than, the other trends which have been accepted by this Commission in past cases. The staff engineers therefore found the reproduction cost new proposals of the company to be "within the zone of reasonableness and acceptable." In arriving at their own estimation of reproduction cost new valuation the staff engineers use essentially the same tabulations of costs and the same trend factors as can be readily seen from a comparison of the reproduction cost new valuations.

Many days of hearings were devoted to testimony with respect to the reproduction cost new valuation. During the course of the cross-examination of company witnesses it was disclosed that a substantial amount of mains had been classified as wood casing mains when they were in fact channel tile and concrete tunnel mains. Reclassification of these mains into the proper accounts has the effect of lowering the reproduction cost new estimate of the company by approximately $325,000 and the estimate of the staff by approximately $353,000. This reclassification, of course, affects the estimates of depreciation as well, since different depreciation percentages apply to the different classifications of mains. The effect on depreciation is discussed under (b) Depreciation.

Except for the error discussed above, the testimony of the company and staff witnesses bore out in detail the reproduction cost new valuations submitted.

The Commission's staff used the book cost of $357,454

in valuing land and land rights. The company submitted an estimate of $432,873 as the value of the land on the date certain. A real estate expert employed by the company testified in support of the latter valuation. The Commission is of the opinion that $432,873 is a reasonable estimate of such value for the purposes of this proceeding.

As is noted above, both the estimates contain the amount of $4,566 for work in progress. This represents property which was in service on the date certain but which had not been closed to the property account records of the company. The Commission finds this inclusion reasonable.

In its estimate of reproduction cost new the company deducted from its various accounts an amount for a so-called "single impulse" adjustment. The engineering staff of the Commission found the amount of the adjustments made by the company to be reasonable and deducted the sum of these adjustments to arrive at its estimate.

(b) Depreciation.

The company's estimate of loss of value due to depreciation was reached by its consulting engineer by means of visual observations of the property. Very few inspections of mains were made prior to the filing of the application. Because of the relatively few number of inspections, the company raised its estimates. Further observations were made after the application which indicated to the witness that his preliminary estimates of loss of value due to depreciation were high. After arriving at its estimates of depreciation to the various classes of property by visual inspection the company made a "special deduction" for excess steam losses in the amount of $772,240.

The reclassification of the mains referred to in the previous section resulted in a decrease in the company's

estimate of depreciation of approximately $375,000. The decrease in depreciation is greater than the decrease in reproduction cost new valuation because the dollars were transferred from wood casing which is older property with a greater amount of depreciation to channel tile and concrete tunnel which is newer property with less depreciation.

The Commission's staff engineers arrived at their estimate of loss of value due to depreciation by means of a field study consisting of a visual inspection of the property and an "office" or actuarial study. The office study consisted of age-life analyses by property accounts. The average service life and the average expired life were estimated for the property in each account. The ratios of expired life to average service were then applied to depreciation curves. Each of these curves is derived from property mortality data and represents the loci of points, each of which shows the percentage of depreciation associated with a given percentage of expired life. Thus, once the type of curve appropriate to the particular account is selected and the ratio of expired life to average service life is determined for the property in the account, the percentage of depreciation is simply the point on the vertical axis corresponding to the point on the curve given by the ratio of expired life to average service life. In this way a percentage of depreciation was estimated for each property account. The results of the office study and the field study were then averaged by accounts to arrive at the staff's final estimate of depreciation.

The reclassification of the mains referred to above resulted in a decrease in the staff's estimate of depreciation of approximately $175,000. The decrease in depreciation estimated by the staff is less than the decrease in the staff's reproduction cost new valuation of mains because the dif-

ference between the percent of depreciation of the newer channel tile and concrete tunnel property and the percent of depreciation assigned to wood casing in the staff's estimate is not as great as it was in the company's estimate.

The Commission has carefully considered the methods and procedures used by the company's witness and by the staff engineers in estimating the depreciation of the property. In the opinion of the Commission, depreciation cannot be determined accurately by visual inspection alone. In this case both the company and the staff engineers gave weight to factors other than those observable by a visual inspection. The company's estimate of percent depreciation is 28.3 percent. The staff's estimate is 28.79 percent. The estimates are so close that a choice between the two makes no great difference in the end result. The members of the Commission themselves differ on what is the best method of estimating percent depreciation. For the purpose of this proceeding, the Commission will use the higher estimate of 28.79 percent depreciation to arrive at a rate base on which to test the reasonableness of the existing and the proposed rates. The use of the lower percent depreciation would result in showing a slightly higher rate base and therefore a slightly lower rate of return at both rate levels.

(c) Working Capital.

The company submitted an estimate of $679,000 for gross working capital. This was based upon a cash requirement of one-eighth of the annual expenses of operation and maintenance, plus the value of materials and supplies on hand calculated on the average month-end balance for the twelve months of 1960, and plus the estimated cost of fuel to be kept on hand. The staff engineers agreed with the company as to the amount of cash re-

quirements and value of materials and supplies, but reduced the amount for fuel to be kept on hand because the estimate of the company exceeded the maximum amount of coal which could be stored at the limited facilities used for this purpose at the steam generating plants. The Commission finds the adjustment made by the staff engineers to be reasonable. As adjusted by the staff, the allowable gross working capital is $530,359. From this should be deducted 50 percent of all tax expense which represents tax accruals available for use as working capital. At present rates the total tax expense is $525,814. Deducting 50 percent of this, or $262,907 from the gross working capital of $530,359 leaves a net working capital of $267,454.

Since it is clear that the net allowance for working capital depends on the amount deducted to reflect cash available from tax accruals, and the latter in turn depends on taxable income which will increase with an increase in revenues, it follows that a determination by the Commission to increase revenues by increasing the rates of applicant will necessitate recalculating the net working capital with a resultant change in the rate base, as will be explained hereafter in the discussion of the company's proposed rates.

(d) Summary.

The estimates of rate base valuation submitted by the company and by the staff, after the adjustments noted above, may be summarized as follows:

	Company	*Staff*
Total Depreciable Property	$26,346,612	$26,327,649
Land and Land Rights	432,873	432,873
Work in Progress	4,566	4,566
Reproduction Cost New	$26,784,051	$26,765,088
Less Depreciation (28.3%)	7,580,585	
(28.79%)		7,706,409
Reproduction Cost New Less Depreciation	$19,203,466	$19,058,679
Working Capital	697,000	267,452*
Statutory Rate Base	$19,900,466	$19,326,131*

In consideration of the foregoing and after consideration of all the probative evidence of record in these proceedings, the Commission is of the opinion and finds that $19,326,131* is a reasonable estimate of the statutory rate base valuation of the property of the applicant used and useful in the rendition of the utility service under consideration for purposes of these proceedings.

REVENUES, EXPENSES AND RETURN AT PRESENT RATES.

Column 1 of the accounting schedule No. 1 of the staff report sets forth revenues, expenses and return at present rates for the year ended December 31, 1960, as shown on the applicant's books. The accounting staff made adjustments to the expenses as follows:

(a) An increase of $5,869.00 for wage increases granted during the test period, annualized,

(b) A decrease in depreciation expense, in the amount of $17,036.00, to account for the difference

* Subject to recalculation upon any allowed increase in revenue.

between the amount determined to be appropriate by the engineers of this Commission and the amount accrued on the company's books of record, and

(c) A decrease of $3,839.88 for federal income taxes as a result of the above adjustments.

The revenues, expenses and return after the adjustments may then be summarized as follows:

Operating Revenues	$3,764,542.60
Operating Expenses	$2,358,375.00
Depreciation	315,964.00
Taxes, other than federal income	357,510.00
Federal Income Taxes	168,303.07
Total Expenses	$3,200,152.07
Return	$ 564,390.53

The return of $564,390.53 represents a rate of return of 2.92 percent at present rates, based upon the statutory rate base of $19,326,131 found by the Commission above.

The Commission finds that such a rate of return is insufficient to provide applicant with reasonable compensation for the utility service rendered by it, having due regard for the depreciated reproduction value of its property devoted to the rendition of such service.

REVENUES, EXPENSES AND RETURN AT PROPOSED RATES

The revenues, expenses and return at the company's proposed rates would result in additional revenue in the amount of $259,425.59. The Commission is of the opinion that expenses would have to be further increased in the amount of $13,854 to reflect the estimated rate case expense of $69,268.00 amortized over a five-year period. With the adjustments for additional gross revenues, in-

creased expenses, and subsequent adjustments in taxes, the revenues, expenses and return at proposed rates may then be summarized as follows:

Operating Revenues	$4,023,968.19
Operating Expenses	$2,372,229.00
Depreciation	315,964.00
Taxes, other than federal income	361,580.38
Federal Income Tax	293,883.70
Total Expenses	$3,343,657.08
Return	$ 680,311.11

As stated above, it will first be necessary to recalculate the rate base since the net allowance for working capital depends on the amount deducted for cash available from tax accruals and the latter depends on taxable income which, in turn, is a function of revenue. At the higher rates authorized in this proceeding, tax accruals would be increased to $655,464.08. Allowable net working capital at increased rates is, therefore, $202,627, computed as follows:

Cash Working Capital	$294,797
Materials and Supplies	115,562
Fuel	120,000
Gross Working Capital	$530,359
Less: 50% of Tax Accruals	327,732
Net Working Capital	$202,627

Adding the net working capital of $202,627 to the reproduction cost new less depreciation of $19,058,679 results in a rate base valuation of $19,261,306.

The return of $680,311.11 represents a rate of return

of 3.53 percent on the above-determined rate base of $19,261,306.

RATE OF RETURN.

Applicant presented two witnesses on rate of return in this proceeding. Witness Brooks estimated that the fair rate of return would be not less than 6.5 percent. Witness Cook estimated that it would be at least 6.66 percent. In spite of this testimony, the company is seeking rates which result in a return which is substantially less, in fact almost 50 percent less than the rate recommended by Witness Cook.

The city's rate of return witness, Mr. Honaker, did not specifically recommend a fair rate of return on the reproduction cost new less depreciation rate base. He recommended instead a "maximum fair earnings permissible" to the company of $525,000 which was based upon a return of 8 percent on invested capital and 13 percent on invested common stock equity capital. In support of these percentages he set forth the percentages earned by the company on these items for the years 1957 through 1960. Mr. Harkins, the city's other rate of return witness, also urged the fairness of 13 percent rate on invested common stock equity. To the extent that the supporting data is meaningful at all, applying, as it does, to investment rather than to the statutory reconstruction cost new less depreciation rate base, Mr. Honaker's data is too narrow to serve as a criterion encompassing only the company under consideration. Mr. Harkins' data is too wide, on the other hand, encompassing many companies and enterprises not at all similar to the company under consideration in size, in character of business, in capital structure, in stability or in any other way. Moreover, while a comparison of the actual return on common stock equity and

invested capital with acceptable levels of earnings of comparable companies could be a useful means of testing the fairness of any given rate of return on the rate base as required by Ohio Court decisions, the decisions have held that the actual earnings requirements of a company "are not really material in a proceeding of this kind." The fair rate of return is a figure which must be determined under Ohio law on the reproduction cost new less depreciation rate base, in the light of all of the facts and circumstances of this case, the rate of return of 3.53 percent resulting from application of the proposed rates to the statutory rate base cannot be considered unjust or unreasonable. The Commission does not decide or attempt to decide whether the rate of return is unjust or unreasonable by any other criteria than those limited few criteria supplied to it by court interpretations of the meaning of the statutes.

ADJUSTMENT CLAUSES.

In an amendment to its application, the company withdrew its proposed tax adjustment clause to which the city of Cleveland had objected.

The company proposed to amend its existing fuel adjustment clause so that for each increase or decrease of 10 cents in coal cost above or below $6.00 per ton the rates increase or decrease:

> "Meter rate: Seven-tenths (7/10) of one cent for each 1,000 pounds of condensation.
>
> "Flat rate: One-half (½) of one cent per square foot of direct air radiating surface per heating season."

The existing fuel cost adjustment rates are higher. The Commission is of the opinion that the proposed amendment to the fuel adjustment clause is reasonable

and should be approved. There remains to be discussed several questions raised by counsel for the city of Cleveland.

First, counsel for the city of Cleveland urges that the application be dismissed "as a matter of comity and equity," charging that the city was not notified in advance of the company's intention to seek an increase in steam rates. There is no obligation on the company under the statutes to give notice prior to filing for a rate increase, and the Commission is without equity power to consider whether good faith required such notice to be given.

Second, counsel for the city of Cleveland urged that steam operations of the company should be considered with electric operations also engaged in by the company, charging an abuse of public trust on the part of the company in failing to bring its combined operations before the Commission as a "package deal."

Section 4909.18 of the Revised Code, dealing with applications to fix rates, requires

> "If such application is for an increase in any rate * * * there shall also be filed * * * a detailed inventory and appraisal of its property used and useful in rendering *the service referred to* in such application * * *."

The application was for an increase in steam rates. The inventory and appraisal therefore properly covered only the property used and useful in rendering steam service. The level of rates is tested upon a rate base consisting of a valuation of steam service properties, including properties allocated partly to use in rendering steam service. Counsel's contention that steam operations should not be considered as a separate entity must therefore be rejected as contrary to law. The Commission further remarks that

to consider the two types of operations together as an entity in order to determine an allowable level of earnings for the over-all company would not obviate the necessity of determining the fair proportion of earnings to be received from any class or type of service in order to avoid unjust discrimination among customers. It appears in this case that for various reasons, principally having to do with competition by other fuels for the heating business, the company is willing to seek a lower return on its property from steam customers than it would seek from electric customers. To apply the contention of counsel for the city of Cleveland to an application by the same company for an increase in electric rates based on over-all operations of the company, including steam operations, would result in higher electric rates than could otherwise be justified on the basis of electric operation alone because the company would recover in electric rates what it failed to seek or failed to recover in steam rates, rather than assume for itself the burden of lower steam rates.

Third, counsel for the city of Cleveland contends the city was denied procedural due process of law, charging the city was severely limited as to time in its cross-examination. The Commission is as aware as counsel of the complexity of the issues raised in rate case proceedings where the valuation of a single item, even the estimated depreciation of the item, is based on judgment. In civil suits days are consumed in valuations of single items which are more rather than less susceptible to exact appraisal. In fact, however, the doubts of the exactness of valuations under a valuation rate base law can never be altogether resolved, nor can differences of opinion be altogether resolved on questions of policy and of bases of judgment going into the construction of rates and rules.

The direct testimony of the company's witnesses con-

sumed approximately four days. Cross-examination consumed approximately 17 days. The Commission is of the opinion that the time allowed was adequate and the thoroughness of the cross-examination will demonstrate the full scope afforded to counsel.

Fourth, counsel urges that the Fourteenth Amendment to the United States Constitution with regard to due process and equal protection of the laws are violated by the laws of Ohio. Since the Commission is not empowered to pass on the constitutionality of statutes it is given to administer, the Commission does not attempt to decide the issue in its various ramifications.

ULTIMATE FINDINGS:

From the evidence adduced upon the record, the Commission renders the following ultimate findings:

(1) The application is filed pursuant to and this Commission has jurisdiction thereof under the provisions of sections 4909.17, 4909.18 and 4909.19 of the Revised Code;

(2) The investigation required under section 4909.19 of the Revised Code has been filed and served as required;

(3) The applicant's statutory rate base for purposes of this proceeding is $19,261,306;

(4) The existing rates now being charged and collected by the applicant are insufficient to provide it with an adequate return on its plant and property used and useful in the furnishing of its service;

(5) The fair annual return of 3.53 percent at proposed rates is not unreasonable or unjust;

(6) The dollar annual return to which applicant is entitled for purposes of this proceeding is $680,-311.11;

(7) That the allowable expenses of applicant for purposes of this proceeding, including operating expenses, taxes and depreciation, aggregate $3,343,-657.08;

(8) That the allowable annual revenue to which applicant is entitled for purposes of this proceeding is $4,023,968.19; and

(9) That the fuel adjustment clause as amended is reasonable and should be allowed.

ORDER:

It is, therefore

ORDERED, that in accordance with the findings and opinion herein set forth, the applicant, Cleveland Electric Illuminating Company, be and hereby is authorized to file with this Commission adjusted tariff schedules in accordance with those set forth in its application as amended. It is, further

ORDERED, that such tariff schedules may become effective on the first billing date subsequent to the filing of such tariff schedules.

THE PUBLIC UTILITIES COMMISSION OF OHIO
FRANCES MCGOVERN,
Chairman,
RICHARD C. ADDISON,
DALE FULTON,
Commissioners.

APPENDIX B.

OPINION OF THE SUPREME COURT OF OHIO.

Public utilities—Steam and hot-water service—Rates determined, how—Finding of Public Utilities Commission not disturbed, when—Valuation of property—Effective date of increased rates.

(No. 38692—Decided July 7, 1965.)

APPEAL from the Public Utilities Commission.

On April 27, 1961, appellee The Cleveland Electric Illuminating Company applied to the Public Utilities Commission of Ohio for authority to raise its rates for steam and hot-water service supplied to users in the city of Cleveland.

After hearing, the commission, on January 8, 1963, found that the existing rates being charged are insufficient to provide the company with an adequate return; that the statutory rate base is $19,261,306; that an annual return of 3.53% is not unreasonable or unjust; that the annual dollar return to which the company is entitled is $680,311.11; that the allowable annual expenses aggregate $3,343,657.08; that the allowable annual revenue to which applicant is entitled is $4,023,968.19; and that the amendment to the fuel adjustment clause of the application was reasonable.

After a rate increase was granted, a motion for rehearing was filed by the city of Cleveland and was denied by the commission.

The case is before this court upon appeal from the order of the Public Utilities Commission granting the requested increase in rates.

Mr. Bronis J. Klementowicz, director of law, *Mr. William T. McKnight* and *Mr. James L. Harkins, Jr.,* for appellant.

Mr. William B. Saxbe, attorney general, *Mr. Jay C. Flowers* and *Mr. Theodore K. High*, for appellee Public Utilities Commission.

Mr. Lee C. Howley, Mr. Harry G. Fitzgerald, Jr., Messrs. Squire, Sanders & Dempsey, Mr. John Lansdale and Mr. Alan P. Buchmann, for appellee The Cleveland Electric Illuminating Company.

Per Curiam. Appellant assigned 55 errors but reduced these assigned errors to four questions to be decided by this court. The four questions are as follows:

1. Has the commission fixed excessive rates which have confiscated the property of appellant and its ratepayers?

2. May the commission utilize published trend factors to aid in valuation of property for the determination of the statutory rate base of the company's property?

3. Is the company's coal escalation clause an unconstitutional delegation by the commission of its power to set rates?

4. Is the commission's order allowing the rate increase retroactive and, therefore, unlawful and unreasonable?

With regard to the first question, the city grounds its case upon its argument that the net return to the company should be based upon "total capitalization" or "net investment."

This argument has been repeatedly rejected by this court because it is in conflict with the rate base formula provided by statute in Ohio, which is reproduction cost new less depreciation.

In *City of Cleveland v. Public Utilities Commission* (1956), 164 Ohio St. 442, 444, this court said:

> "* * * under the Ohio statutes and the decisions of this court, the percentage return is to be related not to the 'total capitalization' or to the 'net investment' but to the statutory rate base (reconstruction cost new less depreciation) so that *neither the actual capital of or net investment in this public utility * * * are really material * * *.*" See *General Telephone Co. v. Public Utilities Commission* (1963), 174 Ohio St. 575, 577; *East Ohio Gas Co. v. Public Utilities Commission* (1938), 133 Ohio St. 212, 218.

There is evidence in the record to support a much higher rate of return than that asked by the company. A finding and order by the commission will not be disturbed unless it appears from the record that such finding and order are manifestly against the weight of the evidence and are so clearly unsupported by the record as to show misapprehension or mistake or willful disregard of duty. *City of Delphos v. Public Utilities Commission* (1940), 137 Ohio St. 422, 428; *East Ohio Gas Co. v. Public Utilities Commission* (1940), 137 Ohio St. 225.

The second proposition raised by the appellant is that a valuation based upon published trend factors, *i.e.*, Handy Whitman and Marshall-Stevens indices, does not conform to Section 4909.05(D), Revised Code, which requires a showing of "values of the separate items comprising such property, together with the unit basis of such valuation."

This Court has previously decided this question in *Lindsey v. Public Utilities Commission* (1924), 111 Ohio St. 6; *Ohio Bell Telephone Co. v. Public Utilities Commission* (1936), 131 Ohio St. 539, 583 (reversed on other grounds, 301 U. S. 292); *Cincinnati Gas & Electric Co. v. Public Utilities Commission* (1962), 173 Ohio St. 473; *City of Dayton v. Public Utilities Commission* (1962), 174

Ohio St. 160 (reversed on other grounds on rehearing [1963], 174 Ohio St. 604).

In its argument on the third question raised, the appellant objects to the company's coal escalation clause on the grounds that the company's present coal escalation clause has not been effective at any time during its existence, that the company has considered such a clause as a means of rate relief and that in accepting it the commission is abdicating its rate-making responsibility.

There is no evidence in the record of any past abuses of customers' rights under this clause, which would indicate that the finding of the commission is unreasonable or unlawful on this ground.

For its fourth proposition appellant asserts that the rates set by the commission were applied retroactively, since they were ordered by the commission to become effective on the first billing date subsequent to the filing of such adjusted tariff schedules, and the company by its billings charged customers at the increased rates from the date of the last billings rather than from the date on which the adjusted tariff schedules were filed.

This matter of the date on which the rate increase was first charged to the customer is a matter between the customer and the company which will not be considered by this court in this appeal from an application of the company to the Public Utilities Commission for an increase in its rates and charges.

On the record, this court can not find that the decision of the commission is unlawful or unreasonable.

The order of the Public Utilities Commission is, therefore, affirmed.

Order affirmed.

TAFT, C. J., ZIMMERMAN, MATTHIAS, O'NEILL, HERBERT, SCHNEIDER and BROWN, JJ., concur.

APPENDIX C.

Journal Entries of the Supreme Court of Ohio.

July 7, 1965:

This cause, here on appeal from the Public Utilities Commission, was heard in the manner prescribed by law. On consideration thereof, the order of the Commission is affirmed for the reasons stated in the opinion herein.

August 19, 1965:

It is ordered by the Court that rehearing in this case is denied.